

LETTER OPINION
99-L-89

October 15, 1999

Mr. Sparb Collins
Executive Director
North Dakota Public Employees
Retirement System
400 East Broadway, Suite 505
P.O. Box 1214
Bismarck, ND 58502-1214

Dear Mr. Collins:

Thank you for your question regarding whether the North Dakota Public Employees Retirement System Board of Trustees may decline to offer disability insurance to members of the defined contribution retirement plan despite N.D.C.C. § 54-52.6-14. Instead of offering disability insurance, the Board proposes to allow a disabled member of the defined contribution retirement plan to withdraw the member's account balance. Allowing such a withdrawal would relieve the member of federal tax penalties for early withdrawal of the retirement funds while also providing some financial support for the disabled member.

N.D.C.C. § 54-52.6-14 states that the Board "shall provide a procedure whereby a participating member may use a portion of that person's account contributions under this chapter to purchase disability insurance." The use of the word "shall" in a statute generally indicates a mandatory duty. Solen Pub. School Dist. No. 3 v. Heisler, 381 N.W.2d 201, 203 (N.D. 1986). Thus, the plain meaning of the statute requires the Board to offer disability insurance that a member has the option of purchasing with a portion of the member's retirement contributions. See Bernhardt v. Bernhardt, 561 N.W.2d 656, 658 (N.D. 1997) ("The use of the word 'may' is permissive and indicates it is a matter of discretion.").

However, the Internal Revenue Service has issued several private letter rulings concluding that when a participating member has a choice of converting some deferred amount into an item which has present value, which would occur if a member were to elect to use some of the member's retirement contribution to purchase disability insurance, then the value of that item should be included within that

Mr. Sparb Collins
October 15, 1999
Page 2

member's current taxable income. Priv. Ltr. Rul. 9405021 (Nov. 8, 1993) (elective deferral allocated to separate retiree medical subaccounts to pay health care premiums includable in gross income); Priv. Ltr. Rul. 9513027 (Jan. 4, 1995) (under assignment of income doctrine, employee election to have contributions to pension plan assigned to health benefit account is assignment of future income for consideration, which is a taxable plan distribution treated as present income when health care account contributions are made notwithstanding that the contributions were used to purchase a nontaxable benefit); Priv. Ltr. Rul. 9104050 (Nov. 1, 1990) (same).

In these letter rulings, the IRS determined that the ability of an employee to elect in the present year to convert a portion of otherwise nontaxable contributions to a pension plan to a purpose other than the pension plan made the amounts subject to that election present income because the employee had present control over the use of that income. This applied even where the income was being used to purchase health care benefits which the employee could not utilize until after the employee retired. The analysis in these letter rulings would apply even more strongly under the situation presented by N.D.C.C. § 54-52.6-14 because the disability benefits contemplated by that section would be available for the immediate use of the employee should the employee become disabled. Based on these letter rulings, allowing a participating member an election or choice to use a portion of that person's account contributions to purchase disability insurance could cause the amounts available for such purchase to become taxable income in the present year.

Allowing these amounts to become taxable is in direct conflict with N.D.C.C. §§ 54-52.6-01(8) and 54-52.6-09(3), which exclude payments for disability insurance and employer retirement contributions, respectively, from inclusion in salary for tax purposes. Accordingly, there is an inherent and irreconcilable conflict between those provisions.

The repeated statutory references to the non-taxability of retirement contributions shows that non-taxability is a primary legislative concern for the defined contribution retirement plan. The Board has determined that this concern can not be assuaged by interpreting the term "shall" in N.D.C.C. § 54-52.6-14 as mandatory. "[W]here it is necessary to effect the legislative intent, the word 'shall' will be construed as 'may'." Solen Public School Dist. No. 3 v. Heisler, 381 N.W.2d at 203. Thus, in order to most fully effect the legislative intent in passing these conflicting statutes, the Board proposes to construe the term "shall" in N.D.C.C. § 54-52.6-14 as directory rather than mandatory.

Mr. Sparb Collins
October 15, 1999
Page 3

It is my opinion that interpreting the term "shall" in N.D.C.C. § 54-52.6-14 as directory rather than mandatory is permissible and furthers the Legislature's paramount intent that the retirement contributions be non-taxable. In addition to furthering the apparent legislative intent, the deference afforded a board's interpretation of its statutes and the savings clause in N.D.C.C. § 54-52.6-18 also support the Board's interpretation of the term "shall." Accordingly, it is my opinion that the Board's decision to allow a disabled member to withdraw the member's account balance without incurring a federal tax penalty, which is allowable under the Internal Revenue Code, is an acceptable resolution of these issues.

Further supporting the Board's interpretation of N.D.C.C. § 54-52.6-14 is the fact the Board was not successful in obtaining a proposal from a disability insurance carrier that would have allowed optional coverage; all of the proposals were for mandatory coverage of all eligible employees. By implementing N.D.C.C. § 54-52.6-14 in the manner the Board proposes, the Board carries out the Legislature's paramount intent of non-taxability while retaining at least some protection for the members against disability.

Sincerely,

Heidi Heitkamp
Attorney General

sam/sc